

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of

Petition Of AT&T Inc. For Forbearance
Under 47 U.S.C. § 160(c) With Regard To
Certain Dominant Carrier Regulations For
In-Region, Interexchange Services

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WC Docket No. 06-120

REPLY COMMENTS OF
ADHOC TELECOMMUNICATIONS USERS COMMITTEE

Lee L. Selwyn
Susan M. Gately
Economics and Technology, Inc.
Two Center Plaza, Suite 400
Boston, MA 02108-1906
617-227-0900

Economic Consultants

James Blaszak
Colleen Boothby
Levine, Blaszak, Block & Boothby, LLP
2001 L Street, NW, Suite 900
Washington, D.C. 20036
202-857-2550

Counsel for AdHoc Telecommunications
Users Committee

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SUMMARY

The comments that have been filed regarding AT&T's Petition seeking forbearance from dominant carrier regulation demonstrate that AT&T's Petition is another move to render the Commission's ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking moot. The Commission should dismiss AT&T's Petition. If the Commission fails to do so, it should deny AT&T's Petition on the merits.

The records in this proceeding and in numerous other proceedings prove that the market for special access services is not effectively competitive. In every instance in which the Commission has given BOCs pricing flexibility, presumably to counter competition, the BOCs have increased their special access rates, rather than lowering them. Not surprisingly, the BOCs are gouging special access customers and earning astronomical returns from special access. An effectively competitive market would not permit such behavior. The price gouging and the astronomical returns persist for only one reason: the special access market is not effectively competitive, and the Commission has refused to intervene.

AT&T and other BOCs supporting AT&T point to statements in recent Commission orders authorizing SBC's acquisition of AT&T and Verizon's purchase of MCI to support their collective assertion that the special access market is intensely competitive. These statements are contradicted by other statements in the same orders and at best are predictive in nature. The actual condition of the special access market is de facto monopolistic. In short, the BOCs provide ineffectual support for their competition claims. Absent effective

competition in the special access market, the BOCs, as other parties have explained and as amplified herein, will be able to exert price squeezes on long distance service competitors and reduce the level of competition in the long distance market – a result certainly inconsistent with the public interest. Accordingly, the Commission cannot not grant AT&T's Petition under the standards set out in Section 10(a) of the Communications Act.

Even if the Commission were to wrongly grant AT&T's Petition, it still must enforce the requirements of Section 272(e) of the Act. The Commission may not simply and completely deregulate AT&T. Absent a separate affiliate for in-region long distance service, the Commission must enforce the imputation requirements embedded in Section 272(e)(3) of the Act. The Commission cannot satisfy this responsibility without information regarding AT&T long distance pricing because without such information the Commission will not know whether AT&T's long distance pricing exceeds the imputed cost of access service. Accordingly, AdHoc suggests that the Commission require AT&T to file price lists with the Commission on a confidential basis. This requirement would not constitute tariff filings, but would give the Commission a tool to help it satisfy its statutory responsibilities. Additionally, the Commission should require a broader imputation for other services and facilities used in common for local and long distance services. AdHoc herein proposes detailed imputation rules. Absent such imputation, AT&T will be free to channel all efficiencies of integration to long distance offerings – to the detriment of local service customers and long distance competitors.

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REPLY COMMENTS OF THE ADHOC
TELECOMMUNICATIONS USERS COMMITTEE

The AdHoc Telecommunications Users Committee (“AdHoc” or the “Committee”) submits these Reply Comments, pursuant to the Commission’s June 23, 2006 Public Notice in the above-captioned docket,¹ regarding AT&T’s Petition for forbearance from dominant carrier regulation of its in-region, interstate, interLATA interexchange services (“in-region IXC services”) after the separate subsidiary requirements of Section 272 of the Communications Act expire.²

INTRODUCTION

AdHoc’s members are among the nation’s largest and most sophisticated corporate buyers of telecommunications services. They include eight “Fortune 100” companies and seventeen of the “Fortune 500.” Committee members come

¹ Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(C) With Regard to Certain Dominant Carrier Regulations for In-Region, Interexchange Services, WC Docket No. 06-120, Public Notice, DA No. 06-1302 (rel. Jun. 23, 2006).

² Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(C) With Regard to Certain Dominant Carrier Regulations for In-Region, Interexchange Services, WC Docket No. 06-120 (filed Jun. 2, 2006) (“AT&T Petition”).

from a broad range of economic sectors (manufacturing, financial services, insurance, retail, package delivery, and information technology) and maintain thousands of corporate premises in every region of the country. Their combined annual spend on communications services is between two and three billion dollars per year. As substantial, geographically-diverse end users of telecommunications service nation-wide, AdHoc members are uniquely qualified to provide a credible, unbiased, and informed perspective on the state of competition in telecommunications markets.

AdHoc admits no carriers as members and accepts no carrier funding. AdHoc members therefore have no commercial self-interest in imposing unnecessary regulatory constraints on incumbent service providers. Indeed, as high-volume purchasers of telecommunications services, AdHoc members have historically been among the first beneficiaries of the FCC's de-regulatory efforts. As a consequence, AdHoc has consistently advocated de-regulation for telecommunications services as soon as a service market becomes competitive.

But local telecom markets, particularly the market for access services, are not yet sufficiently competitive for market forces to discipline the ILECs' prices and stimulate demand-responsive service innovation, as AdHoc has detailed repeatedly to the Commission. Consequently, ILECs have the ability to leverage their market power in the local exchange and exchange access markets to obtain anti-competitive advantages in long distance markets and disrupt the development of (and continuation of) competition, particularly in enterprise markets. The FCC must therefore protect enterprise customers from the

supracompetitive prices and sluggish carrier performance that would result if the Commission prematurely removed all regulatory requirements for the ILECs' services. In particular, the Commission must ensure that its regulatory regime for both local (i.e., access) and long distance markets reflects the competitive realities of those markets and their interdependence as a practical matter.

The instant Petition is a reprise of the forbearance petitions already filed by Qwest³ and Verizon⁴ seeking identical relief and merits only a reprise of AdHoc's response to those petitions given the current state of competition in the affected markets. Like the earlier petitions, AT&T's Petition ignores the fact that the FCC has already initiated the ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking⁵ specifically to address the very issues raised in the Petition. And like those earlier petitions, AT&T's Petition triggers the statutory deadline in Section 10 while adding nothing substantive to the Commission's consideration of the issues being reviewed in that proceeding. Moreover, the AT&T Petition seeks relief from regulatory requirements that are in many cases only hypothetical: because of AT&T's structural separation for its in-region IXC services, those services are already classified as non-dominant. As was true for

³ Petition of Qwest Communications International Inc. for Forbearance from Enforcement of the Commission's Dominant Carrier Rules as They Apply After Section 272 Sunset Pursuant to 47 U.S.C. § 160, WC Docket No. 05-333 (filed Nov. 22, 2005) ("Qwest § 272 Forbearance Petition").

⁴ Petition of the Verizon Local and Long Distance Telephone Companies for Interim Waiver of and Forbearance from Certain Dominant Carrier Regulations for In-Region, Interexchange Services WC Docket No. 06-56 (filed Feb. 28, 2006) ("Verizon In-Region Forbearance Petition").

⁵ Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements, WC Docket No. 02-112, and 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules, CC Docket No. 00-175, Further Notice of Proposed Rulemaking, 18 FCC Rcd 10914 ("ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking").

the petitions filed by Qwest and Verizon, AT&T's Petition is thus a transparent attempt to override the Commission's scheduling priorities and resource allocations by, at best, imposing an artificial deadline on an existing rulemaking and, at worst, preempting the rulemaking altogether. As Comptel pointed out in its Comments on Qwest's similar petition,⁶ the Commission has previously rejected attempts to hijack the rulemaking process by triggering Section 10 deadlines with forbearance petitions seeking prophylactic relief from regulation that is only hypothetical.

Indeed, in AT&T's Comments filed in response to Qwest's earlier petition, AT&T itself urged that, in lieu of diverting the Commission's limited resources to a redundant proceeding to consider Qwest's petition, since the petition merely reiterates the issues already raised in the ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking, the Commission should resolve those issues in the rulemaking, based on the more comprehensive scope and evidentiary record in that docket.⁷ AdHoc agreed then⁸ and agrees now with respect to AT&T's Petition because the same is true of AT&T's instant Petition.

AT&T's attempt to leap-frog the ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking, instead of relying on or refreshing the factual record in that proceeding, while indefensible, is certainly understandable. As was true for Qwest's and Verizon's markets, competitive conditions for enterprise customer

⁶ Opposition of Comptel to Qwest § 272 Forbearance Petition (filed Jan. 23, 2006) at 4-6.

⁷ Comments of AT&T Inc. in response to Qwest § 272 Forbearance Petition (filed Jan. 23, 2006) at 1-2.

⁸ Reply Comments of AdHoc in response to Qwest § 272 Forbearance Petition (filed Feb. 22, 2006) at 3-4.

services have only deteriorated in AT&T's local exchange and exchange access markets since the initiation of the ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking. Because enterprise customers faced no effective competition when AdHoc filed its Comments and Reply Comments in the Rulemaking, AdHoc urged the Commission to impose safeguards and regulatory protections to protect consumers from carrier efforts to impede or restrict competition for their in-region IXC services. "Updating" or "refreshing" the record in the Rulemaking, rather than ignoring it and attempting to deflect attention elsewhere, would have only served to underscore the needs for the kinds of protections advocated by AdHoc at the time.

Protections are still necessary and are still best considered in the context of a rulemaking proceeding – not through sham forbearance requests like the instant Petition filed by AT&T. In its filing today, AdHoc supports key aspects of the regulatory approach to integrated BOC long distance services that the former (pre-merger) AT&T advocated when it considered the issue from the perspective of a BOC competitor, rather than a post-merger BOC.

Non-dominant treatment of AT&T's in-region long distance services is reasonable only under two scenarios. In one scenario, the status quo situation can be maintained, with AT&T agreeing to the retention of the existing separate affiliate, the application of Section 272(e)(3) imputation, and the 47 C.F.R. §32.27 affiliate transaction rules. However, if the separate affiliate is to be collapsed into the BOC local/access entities, non-dominant treatment is appropriate only if

additional rules (discussed in more detail below) are implemented. Something less than tariffing and more than nothing is required.

Rather than simply granting AT&T's Petition (or those of its sister RBOCs that have asked for the same), the FCC should decide these issues in the context of its rulemaking. For all the reasons that follow, at this point in time the Commission cannot relieve an integrated ILEC local/long distance company of all regulations without inflicting serious and permanent harm on the long distance market. ILECs must be given the clear choice to either:

- Maintain separate affiliates with continuing non-dominant treatment for IXC operations. Integral to this must be elimination of the Pricing Flexibility⁹ rules for special access, and implementation of proper regulation of and reductions in special access prices, per AdHoc's numerous pleadings); or
- Integrate access and IXC operations (also with FCC- implemented proper regulation of and reductions in special access prices, per AdHoc's numerous pleadings) and agree to (1) strict enforcement of imputation rules required by Section 272 (e)(3) of the Act, meaning (a) prices of access must be imputed to prices of IXC services, (b) using price list filings by BOCs that could generally be afforded confidential treatment (this does not mean tariffs, nor dominant treatment of IXC operations), and (c) accompanied by

⁹ See 47 C.F.R. §§ 69.701 et seq.; Access Charge Reform, CC Docket Nos. 96-262, 94-1, 98-63, 98-157, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221 (1999) ("Pricing Flexibility Order"), aff'd *WorldCom v. FCC*, 238 F.3d 449 (D.C. Cir. 2001).

vigorous enforcement of any cost allocation and reporting rules necessary to police imputation; and (2) implementation of the special access provisioning standards currently under review in the Performance Standards Rulemaking.¹⁰

In the ILEC Separate Affiliate Dominant/Non-Dominate Rulemaking proceeding the solutions suggested herein have all been made by AdHoc, the pre-merger AT&T and/or other parties. If the Commission concludes that it should take immediate action, it should do so in the Rulemaking, not by taking substantive action on this Petition, or those filed by Qwest or Verizon.

AT&T's Petition presents the Commission with a "Hobson's Choice" since the rules as they exist today offer an all-or-nothing proposition relative to regulatory reporting requirements. The "all" side of the proposition is represented by classification of an integrated BOC long distance service offering as "dominant," which entails tariffing of service and myriad other rules related to the provision of cost support. The "nothing" side of the proposition being classification of that same offering as "non-dominant" with no tariffing and no other reporting requirements at all – in essence no rules to prohibit the integrated firm from leveraging its market power in the provision of broadband special access services into the enterprise long distance market. AdHoc's proposal, discussed in more detail below represents a middle ground – allowing non-dominant classification of an integrated entity, but requiring the imposition of some limited new reporting requirements and imputation rules in order to protect

¹⁰ Performance Measurements and Standards for Interstate Special Access Services, CC Docket Nos. 01-321, 00-51, 98-147, 96-98, 98-141, 96-149, 00-229, Notice of Proposed Rulemaking, 16 FCC Rcd 20896 (2001) ("Performance Standards Rulemaking").

the competition that enterprise customers depend upon in the purchase of long distance voice and data services alive.

I. AT&T'S ACCESS MARKETS ARE NOT COMPETITIVE

The competitive access market described by AT&T in its Petition does not exist. AdHoc has repeatedly urged the Commission to examine the marketplace facts regarding the access services used by businesses and take steps to protect enterprise customers from the ILECs' exercise of market power with respect to those services.¹¹ AdHoc once again urges the Commission to look at marketplace facts and economic realities faced by enterprise customers in access markets rather than the self-serving rhetoric of the carriers.

¹¹ See, e.g., Comments of AdHoc (filed Jan. 22, 2002) at 2-3, filed in Performance Standards Rulemaking; Comments of AdHoc (filed Mar. 1, 2002) at 14-17, filed in Review of Regulatory Requirements for Incumbent LEC Broadband Services; SBC Petition for Expedited Ruling That It Is Non-Dominant in its Provision of Advanced Services and for Forbearance From Dominant Carrier Regulation of These Services, CC Docket No. 01-337, Notice of Proposed Rulemaking, 16 FCC Rcd 22745 (2001) ("Broadband Regulation Rulemaking"); Reply Comments of AdHoc (filed Jul. 1, 2002) at i, filed in Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities, CC Docket Nos. 02-33, 95-20, and 98-10, Notice of Proposed Rulemaking, 17 FCC Rcd 3019 (2002) ("Wireline Broadband Internet Access Rulemaking"); Comments of AdHoc (filed Dec. 2, 2002) at 5, filed in AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, RM No. 10593 ("AT&T Special Access Rulemaking"); Comments of AdHoc (filed Jun. 30, 2003) at 6, filed in ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking; Reply Comments of AdHoc (filed Sept. 23, 2004) at 3-14, filed in Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area, WC Docket No. 04-223, Memorandum Opinion and Order, FCC No. 05-170 (rel. Dec. 2, 2005) ("Qwest Omaha Forbearance Petition"); Reply Comments of AdHoc (filed May 10, 2005), filed in SBC Communications Inc. and AT&T Corp. Application for Approval of Transfer of Control, WC Docket No. 05-65 ("SBC/AT&T Merger Proceeding"); Reply Comments of AdHoc (filed May 24, 2005) at 8-23, filed in Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control, WC Docket No. 05-75 ("Verizon/MCI Merger Proceeding"); Comments and Reply Comments of AdHoc (filed June 13, 2005 and July 29, 2005), filed in Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, WC Docket No. 05-25, RM No. 10593, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994 (2005) ("Special Access Rulemaking"); Comments of AdHoc (filed Feb. 22, 2006), filed in Qwest § 272 Forbearance Petition; Letter from Colleen Boothby, Counsel for AdHoc, to Marlene Dortch, Secretary, FCC, WC Docket No. 04-440 (filed Mar. 16, 2006); Reply Comments of AdHoc (filed Jun. 20, 2006), filed in AT&T Inc. and BellSouth Corp. Applications for Approval of Transfer of Control, WC Docket No. 06-74 ("AT&T/BellSouth Merger Proceeding").

Predictions of a competitive special access market have guided the Commission's regulatory decisions for too long. The factual records assembled in proceeding after proceeding before the Commission (discussed more fully below) demonstrate that those predictions have proven to be woefully inaccurate. As a result, aided by the Commission's failure to update its special access rules to reflect the ILECs' virtual monopoly over special access services, the ILECs (including AT&T) have been able to sustain historically unprecedented prices and profit levels for nearly eight years. Indeed, as AdHoc observed in its earlier pleadings, the Commission's inaction with respect to special access has become a significant obstacle to the development of robust competition in telecommunications markets generally because of the critical role that special access plays as a bottleneck facility for both local and interstate traffic. In order to accurately evaluate AT&T's Petition, the Commission must be willing to accurately assess the state of competition in the special access market.

A. AT&T Offers No Evidentiary Support For Its Competitive Claims, Nor Can It

A gaping hole in AT&T's Petition is the complete dearth of evidentiary support relative to its claims that the market for enterprise local access is competitive. Absent competitive alternatives to enterprise local access facilities, AT&T will be able to leverage its last mile market power into the long distance market. Only two commenters (both ILECs themselves) filed comments in support of AT&T's Petition. Neither discussed or offered any evidence relative to competitive conditions in the local service market for enterprise customer

services.¹²

AT&T devotes most of the text in its Petition to quoting prior Commission statements (including dozens from last year's SBC/AT&T Merger Order) about the level of competitiveness in the long distance market. AT&T's Petition for the most part does not address the lack of competition in the broadband special access market at all. Where AT&T addresses broadband special access market conditions, it provides no evidence to support its assertion of competitive conditions beyond anecdotal references to CLEC "expansion,"¹³ and misleading quotations from the SBC/AT&T Merger Order.

Rather than providing evidence, AT&T's Petition relies upon claims like the following: [t]he Commission has found that CLECs compete vigorously at all levels of the enterprise market. [footnote omitted],¹⁴ citing the recent SBC/AT&T Merger Order. While the quote is accurately reported, its use in this proceeding is inappropriate. The SBC/AT&T Merger Order's findings regarding competitive conditions in the broadband special access market differed significantly from AT&T's characterization. For example, the SBC/AT&T Merger Order found that there were 240,000 commercial buildings with more than 10 DS0 line equivalents provisioned by SBC in the 19 MSAs in which the former AT&T (the single largest CLEC at the time) "owned" last-mile facilities but that the former AT&T's last mile facilities reached only 1,691 of those buildings.¹⁵ While the SBC/AT&T Merger

¹² See generally ACS of Anchorage, Inc. Comments and Verizon Comments.

¹³ AT&T Petition at 20, and footnote 68.

¹⁴ AT&T Petition at 20, and footnote 69.

¹⁵ SBC Communications Inc. and AT&T Corp. Application for Approval of Transfer of Control, WC Docket No. 05-65, Memorandum Opinion and Order, 20 FCC Rcd 18290

Order does not reveal the total number of buildings within these 19 MSAs to which other CLECs connect with their “owned” last mile facilities, there is no evidence that the number of buildings served by other CLECs is anywhere near as high as the number served by the single largest competitor – the former AT&T.

In the instant Petition, AT&T claims that it “could not possibly have any ability to leverage its last-mile facilities to impede interexchange competition because it faces substantial facilities-based competition for both mass market and enterprise local services [footnote omitted, emphasis added],”¹⁶ once again citing the SBC/AT&T Merger Order and providing no actual evidence. In stark contrast to this claim, however, the SBC/AT&T Merger Order made the opposite finding, stating that, while the former AT&T’s facilities were able to reach less than 1% of the relevant commercial buildings,

[t]he record also indicates that, for many buildings, there is little potential for competitive entry, at least in the short term. As the Commission has previously recognized, carriers face substantial fixed and sunk costs, as well as operational barriers, when deploying loops, particularly where the capacity demanded is relatively limited. [footnote omitted] Given these barriers, it appears unlikely that a carrier would be willing to make the significant sunk investment without some assurance that it would be able to generate revenues sufficient to recover that investment. [footnote omitted] Consistent with this analysis, there is evidence in the record that carriers generally are unwilling to invest in deploying their own loops unless they have a long-term retail contract that will generate sufficient revenues to allow them to recover the cost of their investment. [footnote omitted] Moreover, even where there is adequate retail demand, the costs of constructing the loop may be sufficiently high, or there may be other operational barriers, that

(“SBC/AT&T Merger Order”) at footnote 98.

¹⁶ AT&T Petition at 25, and footnote 90.

may deter entry. [footnote omitted]¹⁷

Verizon, in supporting AT&T, claims that there is “vigorous competition for both local and long distance services.”¹⁸ Verizon is wrong, particularly as regards the enterprise local market. Verizon does not distinguish between the mass market and the enterprise market in its claim. All Verizon discussions and support goes to mass market local access. None of it, not one sentence or one iota of evidence, address the broadband special access market.¹⁹

AT&T also argues, without providing any evidence, that its “incentive and ability” to cross-subsidize competitive long distance services with price increases for non-competitive services has been eliminated because of “competition” and “the establishment of pure price caps regulation in all of AT&T’s in-region states.”²⁰ AT&T’s claim is flawed on both fronts.

First, as the Commission acknowledged in the text from the SBC/AT&T Merger Order quoted above, and AdHoc has repeatedly proven, there is no competition for the broadband special access services that are necessary to provide long distance services to enterprise customers. As noted above, AT&T has provided no evidence to support its contentions regarding competition. Second, and without addressing AT&T’s false contention that “pure price caps” eliminates all ability and incentive for cross-subsidization, the broadband special

¹⁷ SBC/AT&T Merger Order at 39.

¹⁸ Verizon Comments at 2.

¹⁹ Verizon Comments at 2-6.

²⁰ AT&T Petition at 26.

access facilities that are the subject of AdHoc's concern are not regulated by the states. And, as AdHoc pointed out in its pleadings in the Special Access Rulemaking, the FCC's Price Caps plan is effectively non-functioning at this time.²¹ The majority of AT&T's special access services have been removed from the remaining vestiges of the price caps regime as a result of the Commission's Pricing Flexibility Rules.²²

B. AdHoc Has Repeatedly Provided Evidence That The Broadband Special Access Market Is Not Competitive

In proceeding after proceeding detailed in footnote 11, *supra*, AdHoc has presented evidence about the lack of competition in the broadband special access markets, the inflated prices the ILEC's can and do charge for those broadband special access services as a result, and the outrageous levels of profit being generated by the RBOCs on those same services, a level of profit that simply could never be sustained in a market that was actually subject to competition. In its comments in the ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking AdHoc detailed factors which demonstrate that effective competition has failed to develop in local exchange and exchange access

²¹ AdHoc Comments at 2-16 and 52-53, and Reply Comments at 3-7 (filed Jun. 13, 2005 and Jul. 29, 2005), filed in Special Access Rulemaking.

²² In the Pricing Flexibility Order, pricing flexibility was granted to the ILECs for special access services in Metropolitan Statistical Areas (MSAs) in which they could demonstrate the existence of certain competitive conditions. In those MSAs in which Phase II pricing flexibility is granted (the category for those MSAs meeting the highest of the two competitive showings), the ILEC is allowed to offer contract-based pricing for special access services in addition to maintaining generally available pricing for those special access customers located in the MSA that have not negotiated special contract agreements. In Phase II MSAs, the generally available pricing is not regulated under the Commission's Price Cap rules, nor are the prices constrained by the Part 69 access pricing structures or levels (para. 153-154). AdHoc estimates that more than 70% of the US population is located in MSAs that have been granted Phase II pricing flexibility.

markets.²³

- The Commission's deregulation of AT&T's prices for special access services (which are crucial inputs for long distance competitors) has resulted in price increases for those services, despite record earnings by AT&T, a result that is fundamentally inconsistent with the outcome of a market with effective competition.
- AdHoc's members – who are the first customers new entrants would seek out – have in fact experienced few competitive alternatives for their exchange and exchange access service requirements.
- Intermodal competition via cable modem service is not a factor for large business users due to the limited deployment of cable infrastructure in business areas and the severe security and reliability concerns raised by cable-based services and technologies.
- Meanwhile, the capital markets for competitive LECs ("CLECs") as a whole have crumbled over the past few years, driving many CLECs out of the market or into bankruptcy and placing severe restrictions on the ability of the few remaining CLECs to stay in the market, let alone expand their service capabilities.

The first of these factors – ILEC increases in access prices in response to pricing flexibility under the Commission's rules – is a particularly troubling competitive barometer. As AdHoc has repeatedly pointed out in the pleadings cited in footnote 11, *supra*, steep price increases in markets where the Commission has granted AT&T and other ILECs Phase II pricing flexibility under Section 69.701, *et seq.* of the rules²⁴ are an outcome exactly opposite to what a competitive market would produce. It confirms that AT&T operates in markets in which it is maintaining its legacy market power.

Indeed, AT&T itself, pre-merger, supported AdHoc's initial analysis of the former SBC's and other ILECs' pricing behavior and amplified it with additional

²³ Comments of AdHoc (filed Jun. 30, 2003) at 4-5, filed in ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking.

²⁴ 47 C.F.R. §§ 69.701 *et seq.*

evidence and analysis to support a petition for reform of ILEC special access rates and regulation.²⁵ More recently, AdHoc documented and updated its analysis of the former SBC's supra-competitive pricing in AdHoc's Comments and Reply Comments in the Special Access Rulemaking²⁶, the SBC/AT&T Merger Proceeding²⁷ and the AT&T/BellSouth Merger Proceeding.²⁸ As the record in that proceeding demonstrates, where ILECs have been granted Phase II pricing flexibility, they have invariably increased, not decreased, their prices for high capacity services; in many cases, those prices are now higher than the prices charged by the same ILECs in geographic areas still regulated under price caps.

Conspicuously lacking from the comments in support of AT&T's Petition is any data even remotely approaching what has been filed in opposition. Similarly lacking, as stated above, all of Verizon's comments in support of AT&T go to sources of mass market local competition, not competition in the enterprise space. Interestingly, although Verizon is in a position to provide actual evidence of competitive conditions based upon its own data, it relies upon trade press reports, and investment analyst statements rather than provide actual data on its own operations.²⁹ The only conclusion to be drawn is that actual evidence does

²⁵ See Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, RM 10593 (filed Oct. 15, 2002) ("AT&T Special Access Petition").

²⁶ Comments and Reply Comments of AdHoc (filed Jun. 13, 2005 and Jul. 29, 2005), filed in Special Access Rulemaking.

²⁷ Reply Comments of AdHoc (filed May 10, 2005), filed in SBC/AT&T Merger Proceeding.

²⁸ Reply Comments of AdHoc (filed June 20, 2006), filed in AT&T/BellSouth Merger Proceeding.

²⁹ Comments of Verizon at 3-4, and footnote 7-13.

not paint nearly as bright a picture as the trade press pronouncements.

Because the competitive alternatives that AT&T describes in its Petition do not exist in AT&T's ILEC region, enterprise networks (and large users generally, including AT&T's IXC competitors) are dependent upon AT&T's in-region access services and are particularly vulnerable to anti-competitive price increases or other attempts to leverage local service market power in order to gain an anti-competitive advantage or fund anti-competitive practices in long distance markets. As the Commission itself observed in the Notice of Proposed Rulemaking for the ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking, a grant of pricing flexibility under the Commission's pricing flexibility rules is not based upon a finding of non-dominance for a carrier's access services.³⁰ Thus, carriers like AT&T who are dominant in their local markets can nevertheless obtain pricing flexibility by nominally satisfying a "trigger" that is based on the number of CLECs with co-locations in ILEC wire centers, in many cases relying upon the co-location of a CLEC that may no longer be in business.³¹ Because

³⁰ ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking at 32.

³¹ "Triggers" represent a type of "shadow evidence" of competition, and often fail to reflect actual marketplace conditions "on the ground." Here, the co-location "triggers" adopted by the Commission as the basis for granting pricing flexibility in a given MSA in actuality have nothing whatsoever to do with the costs and cost/revenue relationships associated with constructing "last mile" fiber connections to specific buildings or interoffice facilities terminating at specific wire centers. A specific building with insufficient demand to justify the cost of constructing a lateral fiber connection can just as easily exist in a district with co-locations sufficient to satisfy the "trigger" as in areas with few or no such co-locations, and the mere fact that the ILEC wire center serving that area happens to host several CLEC co-locations has no bearing upon the revenue/cost conditions at a specific location. In fact, the presence of a CLEC co-location in a particular wire center does more to facilitate that CLEC's use of special access than it does to facilitate replacement of special access with the CLEC's own facilities, in that the CLEC can use the co-location to interconnect whatever limited number of "Type 1" (i.e., CLEC-owned) facilities with special access links leased from the ILEC. By authorizing pricing flexibility based upon the incidence of CLEC co-locations within an MSA, the pricing flexibility "triggers" that were adopted by the Commission have the ironic result of actually enhancing ILEC market power in precisely those areas of greatest business concentration.

local services are crucial inputs for the long distance carriers who compete with AT&T's in-region long distance services, AT&T's continuing dominance in the market for local exchange and exchange access services creates both the opportunity and powerful incentives for it to engage in anti-competitive practices absent regulatory oversight by the Commission.

Despite these marketplace failures, the Commission's current regulatory regime for special access has effectively de-regulated the majority of special access services in the most important metropolitan markets, and has effectively eliminated productivity-based price cap rate adjustments for the remaining special access and switched access services still (in principle) subject to price constraints.

As a result, the BOCs' are continuing to increase prices and earn record-setting profits for special access, which demonstrates that they face little or no competition to protect consumers from exploitive rates and practices.

The BOCs' stunning prices and profits for their business broadband (special access) services are displayed and analyzed in attachments to these Reply Comments. This same data was put into the record by AdHoc for the Commission's review of the pending AT&T/BellSouth merger³² and the prior SBC/AT&T merger review.³³ Attachment A is a white paper released in August, 2004 by the AdHoc Committee's economic consultants, Economics and

³² Reply Comments of AdHoc (filed Jun. 20, 2006), filed in AT&T/BellSouth Merger Proceeding, Attachments A and B.

³³ Reply Comments of AdHoc (filed May 10, 2005), filed in SBC/AT&T Merger Proceeding, Attachments A and B. The materials filed by AdHoc in the SBC/AT&T merger proceeding included data updated through year-end 2004. AdHoc's filing in the AT&T/BellSouth merger proceeding and the instant filing contain results through year-end 2005.

Technology, Inc. (“ETI”). The paper, Competition in Access Markets: Reality or Illusion. A Proposal for Regulating Uncertain Markets (“ETI White Paper”), demonstrates that competitive alternatives simply do not exist for the “last-mile” telecommunications services enterprise customers must have to conduct business.

Attachment B is a declaration by Susan M. Gately, Senior Vice President of ETI, containing updated data for the ETI White Paper where such data exist (“Gately Declaration”). Those data reveal that the BOCs’ overpricing of business broadband services cost American businesses \$21.3 million per day in 2005. At those prices, AT&T’s rate of return for the special access category (after depreciation and taxes) was a jaw-dropping 91.7%. AT&T’s pending merger partner BellSouth earned a return of 98.3%. Figure 1 below plots the earnings of all four of the RBOCs for 2004 and 2005 – showing not only the almost unimaginable scale of the carriers’ profits on special access services, but also that those profits have been sustained, and increasing in magnitude over time.

Today, some seven months later, the biggest changes in the competitive landscape (elimination of UNE-P, loss of AT&T and MCI as access service competitors within their competitive footprint) are producing less, not more, broadband special access competition.

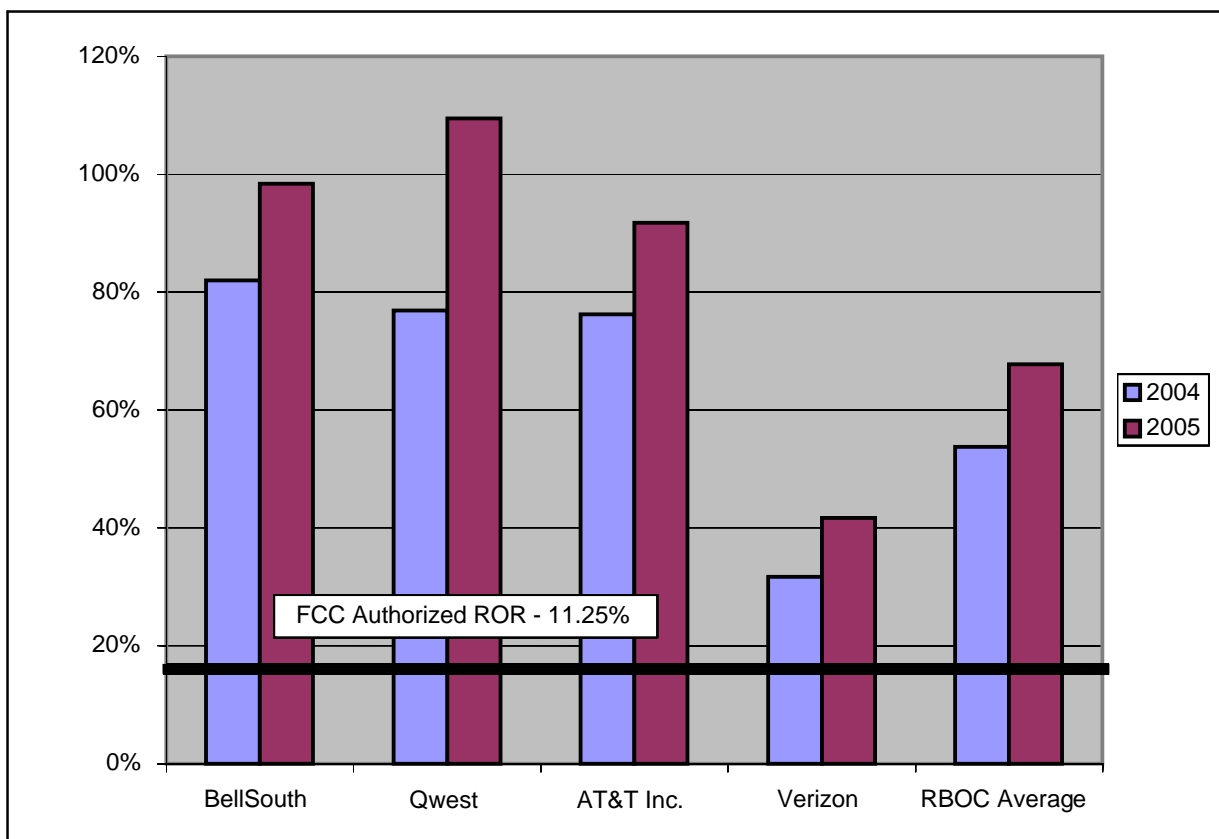


Figure 1: RBOC Special Access Rates of Return – 2004 and 2005

C. AT&T'S Reliance On The SBC/AT&T Merger Order Is Misplaced

AT&T's reliance upon, indeed expansion upon, the FCC's findings regarding the likely impact of the SBC/AT&T merger on broadband special access competition, though understandable, provide entirely ineffectual support for its Petition. AT&T cannot rely on the discussion in that order as evidence of a competitive special access market, for several reasons in addition to those already discussed above.

First, each successive ILEC merger brings the industry to a higher level of concentration.³⁴ Even assuming that the Commission's predictions regarding the

³⁴ See generally discussion in AdHoc Reply Comments (filed Jun. 20, 2006) at 2-14, filed in AT&T/BellSouth Merger Proceeding.

likely impact of the SBC/AT&T merger upon the broadband special access market have any relevance to the issue at hand, the pendency of yet another AT&T merger (with BellSouth) changes the basis for such predictions. As several parties observed in their Comments in the AT&T/BellSouth Merger Proceeding, the Commission has previously identified the heightened incentives and opportunities for competitive harm that result when two Bell Operating Companies merge.³⁵

Second, many key conclusions in the SBC/AT&T Merger Order regarding special access competition are supported by inconsistent or irrelevant evidence or are based on rosy predictions of a competitive future that simply ignores conflicting record evidence. AT&T is quick to capitalize on these findings and adopt them as the support for its Petition, as in the examples quoted above. Indeed, recitation of these findings constitutes the only “proof” that AT&T proffers – as though an actual evidentiary record for this application were superfluous. AdHoc’s reply comments in the AT&T BellSouth Merger Proceeding³⁶ identified several particularly egregious examples of conclusions in the SBC/AT&T Merger

³⁵ See, for example, Comments filed in AT&T/BellSouth Merger Proceeding by Sprint Nextel (filed Jun. 5, 2006) (“Sprint Nextel Comments”) at 5, (“[A]s the Commission found in the SBC/Ameritech merger the expanded service territory of the merged company will increase its incentive and opportunities to engage in anticompetitive practices destined to harm national competitors.”). See also Comments of Cbeyond (filed Jun. 5, 2006) (“Cbeyond Comments”) at 3 (citing SBC/Ameritech Merger Order at para. 18) (“[I]t is hard to fathom how the merger of two RBOCs – each with market power sufficient to be deemed dominant in their own regions – could be said to facilitate a decline in market power and increase in future competition. Indeed, in the most recent RBOC-to-RBOC merger proceeding, the Commission determined that mergers of RBOCs actually harm telecommunications consumers by: (1) denying them the benefit of probable future competition between the merging firms, (2) undermining the ability of regulators to implement the deregulatory framework of the 1996 Act; and (3) increasing the incentive of the merged entity to raise entry barriers and discriminate against competitors.”). These concerns are particularly acute with respect to the ILEC-dominated special access market.

³⁶ Reply Comments of AdHoc (filed Jun. 20, 2006) at 17-20, filed in AT&T/BellSouth Merger Proceeding.

Order – which were either unsupported or were contradicted by record evidence. AdHoc urges the Commission not to rely upon statements made in that order (where competitive conditions were being reviewed in a different manner for an entirely different purpose) to guide it in its decision-making in regards to the instant Petition.

II. NON-COMPETITIVE, DE-REGULATED ACCESS MARKETS IMPEDE COMPETITION IN INTERSTATE INTEREXCHANGE MARKETS

As was discussed in detail in AdHoc's reply comments in the SBC/AT&T Merger Proceeding³⁷ and again just over a year later in the AT&T/BellSouth Merger Proceeding³⁸ the ability and heightened incentive for a post-merger AT&T to leverage its market power over the access inputs upon which its interexchange competitors depend is among the foremost threats to competition in interstate, interexchange markets. For many years before its acquisition by SBC, AT&T was an active and vocal advocate for FCC intervention to prevent anti-competitive practices by the RBOCs leveraging their dominance over access services.³⁹ Although AT&T's silence regarding this issue has been deafening, albeit not surprising, since its acquisition by SBC, these concerns have only increased for the remaining competitors as a result of SBC's vertical integration

³⁷ Reply Comments of AdHoc (filed May 10, 2005) at 21-22, filed in SBC/AT&T Merger Proceeding.

³⁸ Reply Comments of AdHoc (filed Jun. 20, 2006) at 20, filed in AT&T/BellSouth Merger Proceeding.

³⁹ See also Comments of Global Crossing (filed Jun. 5, 2006) at 4-5, filed in AT&T/BellSouth Merger Proceeding; Comments of Cbeyond (filed Jun. 5, 2006) at 88-92, filed in AT&T/BellSouth Merger Proceeding ("Consumers are indirectly harmed when an incumbent LEC's discriminatory practices increase its competitor's general costs and negatively affect the competitor's ability to provide service to its consumers in other regions."); Comments of Comptel (filed Jun. 5, 2006) at 11, filed in AT&T/BellSouth Merger Proceeding.

with its former rival AT&T and then, in short order, its proposed expansion to the BellSouth region.

AT&T and the other RBOCs already have the incentive to discriminate against rivals in the pricing of access service. The integration of their local/access and interexchange operations into a single corporate entity would significantly enhance their ability to engage in such discriminatory practices. Representing a polar opposite position to that advocated by the “new” AT&T in its instant Petition, the pre-merger AT&T was an active participant in the ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking that the instant Petition attempts to leapfrog and had submitted comments, reply comments, and ex parte filings opposing the kinds of changes which are sought by the current embodiment of AT&T.

A. Integration Offers Price Squeeze Opportunities

As a competitor, the pre-merger AT&T understood, and argued, that if an RBOC assesses access charges to competing service providers that are significantly greater than the economic cost of comparable access functions that the RBOC itself confronts, the RBOC would have the ability to impose a price squeeze upon its nonaffiliated rivals by setting its retail end user prices at low levels sufficient only to recover its own economic costs, while forcing competing providers to incur considerably higher out-of-pocket access charges.⁴⁰

⁴⁰ See Comments of AT&T, Corp. (filed Jun. 30, 2003) and associated attachments and appendices, filed in ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking; Reply Comments of AT&T, Corp. (filed Jul. 28, 2003) and associated attachments and appendices, filed in ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking; and Ex Parte Letter from Frank S. Simone, Government Affairs Director, AT&T Corp. to Ms. Marlene Dortch, Secretary, FCC, (filed June 9, 2004) and associated attachments and appendices, filed in ILEC Separate Affiliate

Understandably the new AT&T, now in a position to impose higher access charges on its competitors and to be the price squeezer rather than the price squeegee, is no longer espousing such concerns.

The pre-merger AT&T, however, was not alone in these views.

Congress also recognized this threat as far back as 1996 when the Telecom Act was passed, and in Section 272(e)(3) of the Act required that BOCs:

shall charge the affiliate described in subsection (a), or impute to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service

By specifically not including Section 272(e)(3) as a section that “sunsets” automatically three years after the grant of Section 271 authority in any state, Congress expressly recognized the potential for BOC discrimination against rival carriers with respect to access services, and determined that the need for regulatory oversight with respect to such practices was ongoing, and would therefore need to survive the reintegration of the BOCs’ local/access and interexchange businesses.

ACS of Anchorage, Inc., filing in support of AT&T, is wrong when it claims that “separate affiliate requirements...only serve to create operational inefficiencies.”⁴¹ While persuasive arguments can be made that any “operational inefficiencies” can be addressed by many avenues other than structural integration, that is not the part of ACS’s comments that AdHoc wants to rebut.

Dominant/Non-Dominant Rulemaking.

⁴¹ Comments of ACS of Anchorage Inc. at 2.

Rather, it is the contention that that is the only thing that structural separations achieve. In fact structural separation is what allows the other protective elements of the Act to function. Absent structural separation and without the implementation of other modifications to the Commission's rules, the imputation required by Section 272 (e)(3) of the Act cannot occur.

Although the legal requirement to satisfy Section 272(e)(3) of the Act continues in effect following the sunset of the separate affiliate requirement, the Commission's ability to monitor the BOCs' pricing practices and their compliance with the Section 272(e)(3) imputation requirements would be seriously compromised following reintegration of the kind contemplated by the new AT&T absent some imposition of some additional requirements by the Commission. Once the long distance affiliate is collapsed into the BOC local/access service operations and its interexchange services continue to be treated as non-dominant, the Commission's affiliate transaction "arm's-length" and public reporting requirements disappear, rendering the ongoing determination of Section 272(e)(3) compliance all but impossible.

The conditions surrounding the potential for BOC discrimination in the access service market have persisted, not improved, since the time that the pre-merger AT&T presented economic evidence on this issue in WT Docket 02-112. The acquisitions of the two largest interexchange carriers (former AT&T and MCI) by the two largest RBOCs (SBC and Verizon) that took place in 2005 render the potential for enforcement of Section 272(e)(3) even more difficult, because the entities most likely and best equipped to monitor and challenge the

BOCs' pricing activities (the former AT&T and MCI) have since become part of the RBOCs themselves.⁴²

The recent mergers of SBC with AT&T Corp. and Verizon with MCI, as well as the pending merger of AT&T Inc. and BellSouth, significantly increase the risks of anticompetitive conduct by the remaining RBOCs. By removing as competitors the two largest providers of enterprise services, the RBOCs added the large, preexisting IXC customer bases to further augment their respective access and non-access pricing advantage. Competitors wishing to win clients must take these clients away from the BOCs, a move easily foiled by a BOC capable of offering below-competitor-cost pricing in order to drive competitors out of the market.

The Commission cannot consider the subject Petition in a vacuum, and must take into account the extensive evidence presented by the non-BOC parties – particularly the pre-merger AT&T Corp. and MCI – in WC Docket 02-112. In addition to providing competitive evidence, these filings explain the need for non-access imputation as well as the statutorily required access imputation, and provide a proposed imputation rule to apply to dominant local carriers providing long distance and/or data services on an integrated basis. The imputation rules proposed by pre-merger AT&T are supported by AdHoc and are included as Attachment C to this filing (see discussion in Section III *infra* for more details).

The need for a more detailed imputation requirement and for granular cost allocation is created by the integration of the BOCs' local/access and long

⁴² Regrettably, there is little evidence that the Commission is inclined, on its own motion, to engage in such oversight.

distance businesses into a single corporate entity that would not be classified as “dominant” in the provision of long distance services. As stated above, non-dominant treatment of AT&T’s in-region long distance services is reasonable only under two scenarios. In one scenario, the status quo situation can be maintained, with AT&T agreeing to the retention of the existing separate affiliate, the application of Section 272(e)(3) imputation, and the 47 C.F.R. §32.27 affiliate transaction rules. However, if the separate affiliate is to be collapsed into the BOC local/access entities, non-dominant treatment is appropriate only if a more stringent imputation rule (discussed in more detail below and in the attached June 8, 2004 Selwyn Declaration, included as Attachment D) and a means for replacing the 47 C.F.R. §32.27 affiliate transaction rules is implemented. If the Commission determines that it should grant AT&T Inc.’s Petition with respect to nondominant carrier regulation of in-region interexchange services, it is critical that the Commission concurrently adopt imputation requirements similar to the ones that the pre-merger AT&T Corp. had proposed, and require cost support filings (not tariff filings) proving compliance, in order to enforce Section 272(e)(3) and forestall the RBOCs’ ability to implement an anticompetitive price squeeze.

III. ILEC INTEGRATION OF IN-REGION INTEREXCHANGE SERVICES MUST BE ACCOMPANIED BY COMPETITIVE SAFEGUARDS

Competition and the interests of enterprise customers can only be protected by an access market that is either fully competitive and unregulated or non-competitive and regulated. Forbearance from any regulatory protections when AT&T integrates its non-competitive exchange operations with its

competitive interexchange operations would allow AT&T to exploit an unregulated, non-competitive access market and must therefore be denied.

In an ideal world, rival firms in competitive markets should have equal and equivalent access to all of the principal inputs to the production of their respective products and services; if one such firm happens to wield monopoly control over one or more of these essential inputs, it would have the ability to limit entry and competition in its downstream product market. Sections 251 and 252 of the Telecommunications Act of 1996 (“1996 Act”) and the FCC’s implementation thereof seek to address this condition, specifically with respect to local/access telecommunications services, by requiring that CLECs be afforded nondiscriminatory access to ILEC network resources at prices based upon forward-looking economic cost. In the case of long distance services, if all tariff services required by nonaffiliated IXCs as inputs to their own long distance offerings were priced based upon forward looking economic cost, and if all non-tariff functionality and services that are being used by the BOCs when providing long distance services on an integrated basis were also being offered and available to nonaffiliated IXCs on a nondiscriminatory basis and at prices based upon forward looking economic cost, the BOCs’ opportunity and ability to engage in anticompetitive conduct would be severely constrained.

However, none of these conditions apply in the real world. As such, the use of a fair market value imputation standard – codified at Sections 272(b)(5), 272(c), and 272(e)(3) and as reflected in the Commission’s affiliate transaction rules (47 CFR §32.27) – were all aimed at assuring that the BOCs derived no

unfair competitive advantages as a consequence of their partially integrated provisioning of monopoly local/access and competitive long distance services that were not also available to competing nonaffiliated carriers.

The separate affiliate requirement assured a certain degree of transparency with respect to inter-affiliate intracorporate transactions. The new AT&T's request that it be allowed to eliminate that transparency and be declared non-dominant at the same time would result in a double whammy for those interested in ensuring that competitive alternatives to the RBOC long distance offerings remain viable.

In the event of integration of the local/access and long distance operations of the RBOCs, the transparency afforded by the separate affiliate reporting requirements must be preserved, through specific monitoring, cost allocation, and detailed imputation requirements that are capable of being enforced. The Commission must impose alternate reporting requirements that allow it to track pricing. This is necessary because non-dominant treatment by the Commission of integrated RBOC long distance services would exempt the RBOCs from filing interstate tariffs for their long distance, private line, and other services, and as such there will be no other mechanism for the Commission to review, let alone enforce, the statutory imputation requirement.

Without a price list requirement in conjunction with imputation rules, even after-the-fact enforcement would still be virtually impossible. Therefore, if the Commission decides not to subject the long distance offerings of an integrated RBOC to dominant carrier regulation, it must institute some other non-tariff-based

price reporting requirement for those long distance services that will allow it to ensure compliance with the imputation requirements of Section 272 (e)(3) of the Act.

The cost allocation and imputation rules being proposed by AdHoc here do not include tariffing, nor do they mirror prior stringent cost support requirements. The Commission's rules as they exist today offer an all-or-nothing proposition. The "all" side of the proposition is represented by classification of an integrated BOC long distance service offering as "dominant," which entails tariffing of service and myriad other rules related to the provision of cost support. The "nothing" side of the proposition being classification of that same offering as "non-dominant" with no tariffing and no other reporting requirements at all – in essence no rules to prohibit the integrated firm from leveraging its market power in the provision of broadband special access services into the enterprise long distance market. AdHoc's proposal represents a middle ground – allowing non-dominant classification of an integrated entity, but requiring the imposition of some limited new reporting requirements and imputation rules in order to protect the competition that enterprise customers depend upon in the purchase of long distance voice and data services.

In addition to ensuring compliance with Section 272(e)(3) of the Act, the Commission must have the authority and ability to ensure that RBOCs do not implement a price squeeze based upon improper allocation of non-access costs. Despite AT&T's claims in its Petition, today, more so than at any point since 1984, the BOCs' incumbent local/access carrier operations create and confer

upon their competitive activities formidable market advantages in terms of scale, scope, and “first mover advantage” that competitors will somehow have to overcome in order to remain viable. In that context, the mere imputation of access costs by themselves into retail interexchange service prices, without also capturing the fair market value of any non-tariff services and functions that are provided to the interexchange service affiliate or integrated business unit but for which no explicit payment is made, is not by itself sufficient to prevent cross-subsidization and the creation of a price squeeze; if all that the integrated BOC needed to do in setting its retail interexchange service prices was to equal or exceed the tariffed prices of the underlying access services, the integrated BOC could still create a price squeeze condition for its rivals by setting its price above access but below the total (access plus non-access) cost level. The Commission’s affiliate transaction rules, as codified at 47 C.F.R. §32.27, are specifically intended to address this concern. However, 47 C.F.R. §32.27 will no longer apply once the separate affiliate no longer exists. It is this problem that AdHoc seeks to solve with its proposed middle-ground.

In analyzing AT&T’s Petition, the Commission must acknowledge that if AT&T’s access charges to competing IXCs are significantly greater than the economic cost of comparable access functions that the AT&T realizes itself, it would have the ability to impose a price squeeze upon its nonaffiliated rivals by setting its retail end user prices at levels sufficient only to recover its own economic costs, while forcing competing providers to incur considerably higher out-of-pocket, non-cost-based access charges. We know, from review of the

evidence in Section I *supra*, that AT&T's access charges to competing IXCs are set at levels significantly in excess of cost meaning that there is a real and credible threat of a price squeeze.

Adoption of imputation rules that require imputation of both tariff access charges that a non-affiliated IXC would pay, and imputation of the costs that a non-affiliated IXC would incur to acquire or produce (on a stand-alone, i.e., non-integrated basis) any non-tariff services being provided by the AT&T for the benefit of its (affiliated or integrated) long distance business, can mitigate the potential for such price squeezes but only to the extent that the imputation requirement is properly specified and effectively enforced.

The BOCs have generally contended that integrated operation enables them to produce local and long distance services at a lower combined cost than would prevail under Section 272 structural separation.⁴³ In the instant Petition AT&T claims that unless the FCC forbears from regulating an integrated long distance offering as dominant, consumers will be denied the full benefits of competition.⁴⁴ The imposition of strict imputation and cost allocation requirements advocated by the pre-merger AT&T in the past, and by AdHoc here today, would allow integration, and would not require that any of these economies of scope be sacrificed. Such rules would, however, help to assure that those gains from integration are properly allocated and inure to both segments of AT&T's (integrated) operations in a manner that does not afford an

⁴³ See, e.g., Comments of the Verizon Telephone and Long Distance Companies; Comments of SBC; Comments of BellSouth (filed Dec. 10, 2003), filed in Section 272(b)(1)'s "Operate Independently" Requirements for Section 272 Affiliates, WC Docket No. 03-228.

⁴⁴ AT&T Petition at 6.

undue or unique competitive advantage to the (competitive) long distance business. The entirety of all potential integration efficiencies would be realized, but such gains would be apportioned in a fair and competitively neutral manner. Conversely, without such an imputation requirement, such integration benefits could be conferred to the long distance business in a disproportionately and/or discriminatory manner and would constitute a cross-subsidization of long distance by local/access. The Commission must ensure, through the imposition of new rules, that any “integration efficiencies” are shared, and are not used by the RBOC (in this case new AT&T) to afford itself an undue competitive advantage or to discriminate against, and thereby to disadvantage, its long distance rivals.

The best – and most economically efficient – means for addressing this problem would be to require that access charges and the prices of any non-tariffed services being provided to the BOC’s long distance business unit (whether separated or integrated) be made available to non-affiliated carriers at prices set at forward-looking economic cost. IXCs would then confront the same costs for any tariff or non-tariff services they purchased from a BOC as the BOC itself would confront. If the BOC elected to, in effect, “piggy-back” its long distance services onto its core local services by imposing upon the former only the additional costs (over and above the core services baseline), it would be required to offer those same “piggy-back” prices to nonaffiliated carriers. If access rates and any non-tariff LEC services used to provide BOC long distance services were made available to non-affiliated carriers at prices set at forward

looking economic cost, cross-subsidization would be present only where the actual or effective intra-corporate transfer price did not cover forward looking economic cost – or where no transfer price was even being charged at all.

That “best” and “most economically efficient” means of pricing, however, does not even remotely represent the realities of the contemporary approach to regulation. Therefore, where, as in the present circumstance, prices being charged to nonaffiliated carriers for access and for non-tariff services such as billing and collection are set well in excess of forward looking economic cost, or even embedded, accounting costs – and where some BOC functionality, such as joint marketing, is not even available to nonaffiliated firms – a more comprehensive definition of “cross-subsidization” becomes necessary.

Generally, “cross-subsidization” occurs when telecommunications services that are not subject to regulation by the Commission are priced below cost either (a) by using revenues or profits being derived from services that are subject to the Commission’s jurisdiction or that of another regulatory agency, or (b) by affording the deregulated or nonregulated services access to assets, resources, facilities and functions of the integrated, regulated firm without bearing a fair share of their costs, or when a provider’s deregulated services derive benefits from the regulated operations without the regulated operations receiving just and reasonable compensation from the deregulated operations for the benefits derived.

If the Commission is inclined to grant AT&T’s Petition, AdHoc proposes it also do the following to create a “middle ground”:

- Adopt the definition of cross-subsidization discussed above to ensure that long distance prices offered through an integrated RBOC provider reflect the fair value of the functionality provided from the BOC.⁴⁵
- In order to overcome the elimination of the more transparent inter-affiliate transactions, the integrated BOC should be subject to strict cost allocation requirements as between its monopoly local services and its competitive interexchange services.⁴⁶
- In order to ensure that RBOC pricing reflects the fair market value of any non-access elements of its integrated services, the BOCs should be required to impute into retail prices charged, costs for all joint functions and the joint use of all RBOC assets or resources. These imputed costs should satisfy both the requirements of Section 272(e)(3) with respect to access and, for non-access services and functions, the Commission's 47 C.F.R. §32.27 affiliate transaction rules. The imputation rules proposed by the pre-merger AT&T should be used as a model – these rules are appended to these comments as Attachment C.

⁴⁵ The full value of services undertaken by a BOC on behalf of its long distance operations should correspondingly be imputed as a revenue to be credited against the cost of providing the BOC's regulated monopoly local exchange and access services.

⁴⁶ Note that Part 64 cost allocations are not sufficient for this purpose, since they involve cost allocation as between regulated and nonregulated services. The allocations that are required under integrated local/interexchange operations are more complex.

CONCLUSION

AdHoc urges the Commission to deny AT&T's Petition in its entirety, and to address and resolve the issues raised therein in the ongoing ILEC Separate Affiliate Dominant/Non-Dominant Rulemaking. The Commission should soundly reject AT&T's transparent attempt to dictate the Commission's agenda and to end-run an ongoing rulemaking proceeding.

For all the reasons discussed above, at this point in time the Commission cannot relieve an integrated ILEC local/long distance company of all regulations without inflicting serious and permanent harm on the long distance market. A new middle ground must be created through the imposition of new rules specifically designed to protect enterprise customers from the abuses that a non-dominant integrated LEC could perpetrate on the competitive marketplace under the Commission's existing rules. ILECs desiring non-dominant treatment of their long distance offerings must be given the clear choice to either:

- Maintain separate affiliates with continuing non-dominant treatment for IXC operations. Integral to this must be elimination of the Pricing Flexibility rules for special access, and implementation of proper regulation of and reductions in special access prices (per AdHoc's numerous pleadings); or
- If they choose to integrate access and IXC operations (also with FCC- implemented proper regulation of and reductions in special access prices, per AdHoc's numerous pleadings) they must be willing to be subject to (1) strict enforcement of imputation rules

required by Section 272 (e)(3) of the Act, meaning (a) prices of access must be imputed to prices of IXC services, (b) using price list filings by BOCs that could generally be afforded confidential treatment (this does not mean tariffs, nor dominant treatment of IXC operations), and (c) accompanied by vigorous enforcement of any cost allocation and reporting rules necessary to police imputation; and (2) implementation of the special access provisioning standards currently under review in the Performance Standards Rulemaking.

Respectfully submitted,

ADHOC TELECOMMUNICATIONS
USERS COMMITTEE

By:



Lee L. Selwyn
Susan M. Gately
Economics and Technology, Inc.
Two Center Plaza, Suite 400
Boston, MA 02108-1906
617-227-0900

Economic Consultants

James S. Blaszk
Colleen Boothby
Levine, Blaszk, Block & Boothby, LLP
2001 L Street, NW, Suite 900
Washington, D.C. 20036
202-857-2550

Counsel for AdHoc Telecommunications
Users Committee

August 8, 2006

Certificate of Service

I, Michaelleen I. Terrana, hereby certify that true and correct copies of the preceding Reply Comments of AdHoc Telecommunications Users Committee were filed this 8th day of August, 2006 via the FCC's ECFS system and by email to:

Marlene H. Dortch
Office of the Secretary
Federal Communications Commission
Room TW-A325
445 12th Street, SW
Washington, DC 20554

Randy Clarke
Pricing Policy Division
Wireline Competition Bureau
Federal Communications Commission
Room 5-A360
445 12th Street, SW
Washington, DC 20554
randy.clarke@fcc.gov

Best Copy and Printing, Inc. (BCPI)
Portals II
445 12th Street, SW
Room CY-B402
Washington, DC 20554
fcc@bcpiweb.com



Michaelleen I. Terrana
Legal Assistant